

Testimony of the
U.S. Public Interest Research Group

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**Oversight Hearing On
Abusive Credit Card Industry Practices**

**Before the Subcommittee
On Financial Institutions and Consumer Credit
Of the Financial Services Committee,
U.S. House of Representatives
Honorable Carolyn Maloney, Chair**

7 June 2007

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 1

Chair Maloney, ranking member Gillmor, members of the committee:

Thank you for the opportunity to offer U.S. PIRG's views on abusive credit card industry practices. We commend you for having this timely hearing. I am Edmund Mierzwinski, Consumer Program Director of U.S. PIRG. As you know, U.S. PIRG serves as the federation of and national lobbying office for state Public Interest Research Groups. PIRGs are non-profit, non-partisan public interest advocacy organizations with offices around the country.

SUMMARY:

Owning a credit card company is truly a license to steal. The credit card industry, for years easily the most profitable form of banking according to Federal Reserve Board annual reports to Congress, has seen its profits grow to new heights on the wings of revenue derived from punitive APRs of 32% or more, imposition of late and over-the-limit fees of up to \$39 issued on a repeat basis for purported violations that may not have been violations and from the cumulative effects of deceptive disclosures of the true cost of credit, especially in the case of minimum monthly payments. The failure to adequately disclose the cost of credit encourages the most at-risk members of the customer base to carry large unpaid balances at unaffordable interest rates and leaves them in a cycle of perpetual debt. Concentration of the industry has resulted in a tight oligopoly where the largest and most powerful players act with impunity. Once vigilant state enforcers have been de-fanged; private enforcement is hampered by unfair binding mandatory arbitration and federal agencies merely aid and abet bank practices, instead of regulating them. The credit card industry operates without fear of either market or regulatory action to temper its excesses, at the expense of the public's welfare.

While we concur 100% with the comprehensive analysis offered today by our fellow witness Kathleen Keest of the Center for Responsible Lending of proposed Federal Reserve Board changes to Truth In Lending Act (TILA) disclosures, we note that her testimony's main point is to stress the general limitations of the disclosure approach as a restraint on unfair or deceptive practices that leave vulnerable consumers trapped in a cycle of debt. The Congress must act immediately to restore state and local enforcement efforts over national banks, make it easier for consumers to enforce the law themselves and must also explicitly ban the industry's sharpest and most egregious practices.

As the CRL testimony explains, some of what the Fed proposes is good, some of it is bad, but on the whole, disclosure is only a small part of the solution. It is not a substitute for substantive consumer protections, including prohibitions on the practices that even the industry's name brand, supposedly blue chip players, engage in. Throughout, these players have been aided and abetted by actions of the Office of the Comptroller of the Currency (OCC), which misplaces the self-serving doctrine of federal preemption as somehow being above the public interest goal of ensuring that taxpayer-guaranteed financial institutions treat the American public fairly.

It is important to recognize that when TILA was enacted in 1968 its federal disclosure rules were buttressed by a framework of strong, enforced state consumer protection laws. Then, the Supreme Court's 1978 Marquette (holding that credit card companies could export high interest rates nationwide from their own home states) and 1996 Smiley (extending that holding to include fees) decisions encouraged both the consolidation of the industry and its move into a few safe harbor states. Then, following enactment of the 2004 OCC rules further preempting state enforcement

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 2

authority, the extremely concentrated credit card industry increased its ability to engage in a growing and wide number of unfair, anti-consumer practices. Today, it operates in a deregulated marketplace where state enforcement efforts have been shut down and state consumer laws have been preempted. Of course, the industry happily complies with the laws of those safe harbor states from which the OCC and other pliant federal regulators allow it to operate nationwide under only their federal “enforcement.” The OCC and other federal bank regulators have largely ignored the industry’s unfair practices while their regulatory and legal actions have only encouraged them. The OCC’s few consumer enforcement actions have largely been limited to efforts against obscure institutions accompanied by modest guidance letters for the industry as a whole.

Nor can consumers protect themselves in this marketplace. Unfortunately, due to the widespread use of binding mandatory arbitration clauses in credit card and indeed all bank account contracts, private consumer enforcement is nearly impossible.

Numerous credit card complaints to consumer groups allege that companies raised rates when bills were paid on time. Others allege that rate increases were due to alleged late payments to someone else; yet, the banks have told other Congressional panels that they do not engage in this practice, known as universal default. Worse, the firms are allowed to change the rules at any time, for any reason, including no reason.

The real solution is not disclosure. The solution, in our view, is to ban the most unfair practices, reinstate the authority of state regulators to enforce their consumer protection laws, and to prohibit unilateral changes of terms clauses and mandatory arbitration clauses.

(1) INTRODUCTION TO UNFAIR CREDIT CARD PRACTICES

The most common unfair credit card company practices include the following:

- Unfair and deceptive telephone and direct mail solicitation to existing credit card customers – ranging from misleading teaser rates to add-ons such as debt cancellation and debt suspension products, sometimes called “freeze protection,” which are merely the old predatory product credit life, health, disability insurance products wrapped in a new weak regulatory structure to avoid pesky state insurance regulators¹;
- Increasingly, the use of unfair penalty interest rates ranging as high as 30-35% APR or more, including, under the widespread practice of “universal default,” imposing such rates on consumers who allegedly miss even one payment to any other creditor, despite a perfect payment history to that credit card company;
- Imposing those punitive penalty interest rates retroactively, that is on prior balances, further exacerbating the worsening levels of high-cost credit card debt;
- Imposing higher late payment fees, which are often levied in dubious circumstances, even when consumers mail payments 10-14 days in advance;
- Using a variety of mail trickery, such as changing the due dates of monthly bills, making the due date a Sunday but not posting on the weekend; shortening the period between when a bill is mailed out and when that bill is due, etc.;
- Increasing the use of aggressive and deceptive marketing to new customer segments, such as college students with neither a credit history nor an ability to repay and to persons with previous poor credit history;

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 3

- Making partnerships with telemarketers making deceptive pitches for over-priced freeze protection and credit life insurance, roadside assistance, book or travel clubs and other unnecessary card add-ons;
- Imposing unfair, pre-dispute mandatory arbitration² as a term in credit card contracts to prevent consumers from exercising their full rights in court; and the concomitant growing use of these arbitration clauses in unfair debt collection schemes;
- The failure of the industry to pass along the benefits of what, until recently, were several years of unprecedented the Federal Reserve Board interest rate cuts intended to provide economic stimulus, through the use of unfair floors in credit card contracts.
- Using the clause “Any term can be changed at any time for any reason, including no reason” in credit card contracts as allowed by Delaware and other safe harbor state laws.

The practices described above can be illustrated with the following examples:

- Banks entice consumers to open or continue credit card accounts with promises of a fixed interest rate on unpaid balances on purchases. Thereafter, they unilaterally increase the so-called fixed rate, and may change it to a variable rate³.
- Banks bait and switch credit card consumers with teaser offers promising a low introductory interest rate on additional credit card debt and the consumer’s pre-existing (regular) interest rate thereafter. But after individual consumers accept the offer and increase their unpaid balance, banks unilaterally and without notice raise the consumer’s regular interest rates because now, the individual consumer’s debt is allegedly “too high.”
- Banks ignore consumers’ disputes to charges, which, according to banks themselves, need not be paid pending resolution. Instead, banks unilaterally use such non-payment to charge late fees and raise interest rates.
- Banks reduce credit limits of consumers on their credit card accounts unilaterally and without advance notice, and do so in such manner and to such an extent as to intimidate consumers into abandoning their legitimate objection to charges.
- Banks fail to adequately inform consumers in advance of a proposed increase in interest rate based on the individual consumer’s purportedly high debt or other information in such consumer’s credit report. Thereby, consumers have no opportunity to avoid the increased interest rate, and are saddled with significant additional interest payments without advance notice.
- Credit card companies use low, short-term “teaser rate” introductory APRs to mask higher regular APRs. The introductory APR is one of the primary tools used to market a card, and it usually appears in large print on the offer and envelope. In a PIRG study, of the 100 card offers surveyed, 57 advertised a low average introductory APR of 4.13%. Within an average of 6.8 months, the regular APR shot up 264% to an average regular APR of 15.04%. The post-introductory APR, as well as the length of the introductory period, were not prominently disclosed.
- Important information is disclosed only in the fine print of the offer. For example, the fine print of most offers states that if an applicant does not qualify for the offered card, s/he will receive a lower-grade card, which usually has a higher APR and punitive fees (a practice called “bait and switch”). The fine print is easy to overlook, and as a result, a consumer may receive a card that s/he did not want.

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 4

- Free does not mean free. The “free” offers that are advertised with many cards are not usually as impressive as they appear. Most have significant restrictions or hidden costs, such as enrollment fees or expiration dates.
- Companies are failing to disclose the actual APRs of cards. Increasingly, credit card companies are quoting a range of APRs in offers rather than a specific APR, a practice called “tiered” or “risk-based” pricing. These ranges are frequently so wide as to be utterly useless to consumers.
- Fine print fees for cash advances, balance transfers, and quasi-cash transactions such as the purchase of lottery tickets significantly raise the cost of these transactions. But the terms governing these transactions are buried in the fine print, where consumers can easily miss them. Minimum fees, also stated only in the fine print, allow credit card companies to guarantee themselves high fee income regardless of the transaction amount.
- Card companies now impose multiple APRs – one for balance transfers, one for purchases and one for cash advances, for example – but apply monthly payments first to the balance with the lowest APR, ensuring that it will take the longest to pay off the card.

Another way to look at these problems is to look at an example: In a recent court complaint against a credit card company, a consumer attorney pleaded the following facts:

On June 17, 2002 the balance owed on the consumer’s account was \$702.00. On June 18, 2002, the bank added a \$59 club membership fee that caused the consumer’s account to exceed his credit limit by \$11 (the balance owed was \$761 and the credit limit was \$750). From June 2002 until August 2004, even though the consumer made timely monthly payments each month, the bank added \$435 in over-limit fees to this account and \$495 in late charges on this account.

This consumer responded to some bank-initiated telemarketing pitch or bill insert to join some sort of a membership club, then the bank allowed him to go over his limit to complete the transaction for a purchase it itself had initiated, then that triggered an ongoing cascade of repeated late and over-the-limit fees that have caused the consumer to end up in a cycle of rising debt even though he no longer uses the card. This example, multiplied by millions of consumers, gives you an idea of how credit card debts have piled up in this country.

(2) PRIOR TO ENACTMENT OF THE 2004 OCC RULES, STATE AND LOCAL ENFORCERS HELPED POLICE THE MARKETPLACE AND BY THEIR ACTIONS ENCOURAGED OCC TO DO SO ALSO

In the late 1990s, consumer advocates and state enforcers and even federal regulators began to notice an increase in unfair credit card practice complaints. Even the Treasury Department’s Office of the Comptroller of the Currency (OCC), no consumer protector, began to escalate the appearance of its efforts against unfair credit card company practices at the time. Although it did not take any public actions against any well-known major institutions, it did file enforcement actions against a few obscure, small fringe institutions after one case against an albeit large, but relatively upstart mono-line⁴ credit card bank, Providian (now part of Washington Mutual (WAMU)).

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 5

The OCC's 2000 action against Provident was only after the San Francisco District Attorney and the California Attorney General initiated earlier and widely-praised enforcement actions. As we list below, a number of states aggressively took action against credit card companies in this time frame as well. Most of these state and local actions would generally be prohibited now, after promulgation of the 2004 OCC preemption rules. More recently, following intense criticism, including from this committee, the OCC has consolidated a summary of its actions onto one website to make its efforts appear more comprehensive⁵. Over the last four years, OCC has also issued a series of modest regulatory guidances admonishing banks against certain common unfair practices, but has not imposed any recent publicly-disclosed civil penalties.

(A) Despite Massive Numbers of Complaints, OCC Engaged In No Publicly Disclosed Self-Initiated Actions Against Any Top Ten Banks

In 2006, as in previous years, 39% of OCC's complaints were against credit card banks.

According to the GAO:

“from 2000 through 2004, credit cards were the most common product involved in complaints addressed by OCC, FDIC, and the Federal Reserve. According to officials from OCC and FDIC, complaints about credit cards will continue to remain high because consumers have multiple credit cards and use them frequently. Credit card complaints accounted for, on average, about 39 percent of all complaints handled by OCC, from 2000 through 2004. For FDIC, the amount was nearly 29 percent and for the Federal Reserve, approximately 40 percent.”⁶

Yet, even the GAO explains that the large number of credit card complaints to OCC versus to other regulators is because it supervises so many large banks. Yet, to our knowledge, the OCC has not imposed public penalties or sanctions on any of the nine of the current “Top Ten” banks under its regulation⁷, even though most advocates believe the sharp practices are endemic to the industry, including its largest players. Curiously, around the same time that the Provident case was being investigated, several private lawsuits were settled against First USA/Bank One (a Top Ten issuer at the time, now part of Chase). According to a FOIA request U.S. PIRG filed at the time, complaints to the OCC against First USA/Bank One dwarfed all others to the OCC. Yet, to our knowledge, the OCC never imposed penalties against that bank. The complaints were largely concerning disputes over timely payments charged as late.

Further, as Professor Art Wilmarth⁸ testified before this subcommittee in April 2007:

The OCC's record is similarly undistinguished with respect to consumer enforcement actions taken against national banks for violations of consumer protection laws. Since January 1, 1995, the OCC has taken only thirteen public enforcement actions against national banks for violations of consumer lending laws. With two exceptions, all of those actions were taken against small national banks... Since January 1, 1995, the OCC has not issued a public enforcement order against any of the eight largest national banks for violating consumer lending laws. In contrast to this absence of public enforcement action by the OCC against major national banks, state officials and other federal agencies have issued numerous enforcement orders against leading national banks or their affiliates – including Bank of America, Bank One, Citigroup, Fleet, JP Morgan Chase, and US

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 6

Bancorp – for a wide variety of abusive practices over the past decade, such as predatory lending, privacy violations, telemarketing scams, biased investment analysis, manipulative initial public offerings, and allowing hedge funds to engage in late trading and market timing in bank-sponsored mutual funds. [Citations omitted.]

(B) Meanwhile, State Attorneys General Had Aggressively Enforced The Law (Prior To Issuance of the 2004 OCC Rules)

Of course, state Attorneys General, always the top consumer cops on the beat, had long been aggressively pursuing crime and other anti-consumer practices in the credit card suites. Some late 20th - early 21st century actions by state Attorneys General included the following.

- Beginning in 1999, the Minnesota Attorney General and other states settled multi-million dollar claims against U.S. Bank for its practice of allowing telemarketers access to its credit card customer records for the purpose of deceptively marketing add-on products including credit life insurance, roadside assistance packages, and other gimmickry billed to consumers who did not even give their credit card numbers and had no knowledge that they had allegedly placed orders or would be billed for any product.
- In December, 2002, 28 states and Puerto Rico settled a case with the aforementioned First USA (a unit of Bank One, which is now part of JP Morgan Chase after its acquisition of Bank One) “that will provide new protections against misleading telemarketing campaigns for more than 53 million credit card holders. First USA Bank N.A. - the largest issuer of Visa credit cards - and also known as Bank One Delaware NA, has agreed to implement broad reforms in its relationships with third-party vendors to ensure that non-deceptive marketing campaigns are used in soliciting the bank's credit card holders. Specifically, under the agreement, First USA must prohibit vendors from engaging in deceptive solicitations.”⁹
- In February 2002, 27 states negotiated an agreement for Citibank, then the nation’s largest credit card issuer, to stop deceptive practices in the marketing of similar tawdry add-on products. “The states raised concerns that the marketing practices of Citibank’s business partners were deceptive and often resulted in consumers being charged for products and services - such as discount buying clubs, roadside assistance, credit card loss protection and dental plans - that they had no idea they agreed to purchase.”¹⁰
- Prior to issuance of the 2004 OCC rules, numerous state Attorneys General, including Minnesota¹¹, Texas, West Virginia, New York and others had filed actions against the large sub-prime credit card company Cross Country Bank for its deceptive and predatory practices when marketing to consumers with impaired credit histories. The Attorney General of Minnesota’s complaint alleged use of racial, derogatory and abusive epithets in the bank’s contacts with customers¹². The Attorney General of Pennsylvania had this to say in 2004: “Instead of helping consumers as promised, the defendants actually pushed cardholders further into debt when they used the credit cards. Those who failed to make the payments, were subjected to a barrage of abusive, harassing collection practices that included the use of profanity and multiple calls to consumers' homes or offices.”¹³
- In January 2005, Minnesota Attorney General Mike Hatch filed an unfair practices suit against Capital One Bank and Capital One F.S.B. for using false, deceptive and misleading television advertisements, direct-mail solicitations, and customer service telephone scripts to market credit cards with allegedly "low" and "fixed" interest rates that, unlike its competitors' rates, supposedly will never increase. Capital One, of course, is one of the nation’s largest credit card

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 7

companies, with an aggressive advertising campaign urging consumers to put a Capital One card in their wallet and avoid the other companies, generally portrayed by Capital One as Vikings, Visigoths or other sorts of plundering barbarians. Other states, including West Virginia, also announced parallel investigations of Capital One. West Virginia, this month, had to file suit to enforce its subpoenas against the bank.¹⁴ In 2006, Minnesota settled with Capital One.¹⁵

(C) After State and Local Prodding, The OCC Began To Awaken

- In 2000, the tiny San Francisco District Attorney and the California Attorney General¹⁶ began an investigation later joined by what many claim was an embarrassed and late to the party OCC, which resulted in imposition of a minimum of \$300 million in civil penalties and a restitution order against Provident for deceptive marketing of mandatory credit life insurance, known as freeze protection, and other violations. The OCC, not generally known for hyperbole in defense of the consumer, said the following: “We found that Provident engaged in a variety of unfair and deceptive practices that enriched the bank while harming literally hundreds of thousands of its customers¹⁷.”
- In 2001, the OCC imposed multi-million dollar penalties and a restitution order against Direct Merchants’ Bank its practice of “‘downselling’ consumers by prominently marketing to consumers one package of credit card terms, but then approving those consumers only for accounts with less favorable terms, and touting the approved account in a fashion designed to mislead the customer about the fact he or she had been ‘downsold’¹⁸.” The OCC subsequently brought a few cases against other obscure national banks between 2001-2003.¹⁹ Apparently, no penalties have been imposed since.

(D) Some Success For Private Plaintiffs In That Time Frame

While the rise in state enforcement was stymied by imposition of the OCC rules in 2004, some private plaintiffs have always attempted to enforce the law. In the early years of this century²⁰, several private class action lawsuits were also settled against other large banks for abusive practices, such as cases against Bank One/First USA for charging consumers late fees, even when they pay on time. In addition, in 2003, the 3rd Circuit found that Fleet Bank had violated the Truth In Lending Act (TILA) when it promised Paula Rossman a no-annual-fee credit card and changed the terms immediately, less than a year after she’d obtained the card, even though Rossman had not violated any of the contract’s terms by paying late, going over her limit, or anything else. The court described the essential problem this way:

A statement, therefore, that a card has "no annual fee" made by a creditor that intends to impose such a fee shortly thereafter, is misleading. It is an accurate statement only in the narrowest of senses--and not in a sense appropriate to consumer protection disclosure statute such as the TILA. Fleet's proposed approach would permit the use of required disclosures--intended to protect consumers from hidden costs--to intentionally deceive customers as to the costs of credit.²¹

Of course, Rossman highlights one of the critical hypocrisies and significant flaws in the federal un-regulation of the credit card marketplace, where credit card contracts are take-it-or-leave contracts of adhesion imposed on consumers that purport to allow the bank to make any changes at any time for any reason. As the court quotes Fleet’s contract in Rossman:

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 8

We have the right to change any of the terms of this Agreement at any time. You will be given notice of a change as required by applicable law. Any change in terms governs your Account as of the effective date, and will, as permitted by law and at our option, apply both to transactions made on or after such date and to any outstanding Account balance.²²

In summary, then, it has become almost impossible for state enforcers to act against large credit card companies and it has also become difficult for private enforcement to police the marketplace due to mandatory arbitration clauses limiting consumer efforts. Efforts need to be taken to improve the ability of state and private enforcers to police the credit card market.

(3) ABUSIVE CREDIT CARD INDUSTRY PRACTICES ON CAMPUS AND TO NEW CUSTOMER POPULATIONS

Having saturated the working adult population with credit card offers, credit card companies are now banking on new markets: college students and others who have never had, or had only limited access to, credit cards. See, for example, “Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers,” testimony to the Senate Banking Committee summarizing a recent report by the National Council of La Raza,²³ which details a variety of challenges Latino credit card consumers face, including greater vulnerability to scams, reliance on higher-priced cards and difficulty working with the OCC’s “obscure consumer complaint system.”

As for college students, under regular credit criteria, many students would not be able to get a card because they have no credit history and little or no income. But the market for young people is valuable, as industry research shows that young consumers remain loyal to their first cards as they grow older. Nellie Mae, the student loan agency, found that 78% of undergraduate students had credit cards in 2000. Credit card companies have moved on campus to lure college students into obtaining cards. Their aggressive marketing, coupled with students’ lack of financial experience or education, leads many students into serious debt. According to a recent PIRG study, the Burden of Borrowing, credit card debt exacerbates skyrocketing student loan debts. That 2002 study found that thirty-nine percent (39%) of student borrowers now graduate with unmanageable levels of debt, meaning that their monthly payments are more than 8% of their monthly incomes. The study also found that student borrowers were student borrowers were even more likely to carry credit card debt, with 48% of borrowers carrying an average credit card balance of \$3,176.²⁴

In 2004, Maryland PIRG and the Maryland Consumer Rights Coalition releasing a study of credit card marketing practices on the state’s college campuses. Among the highlights of Graduating Into Debt²⁵ were the following:

- Credit card vendors are setting up tables on some campuses in violation of university policies prohibiting or limiting tabling.
- At least two schools currently sell their student lists (names, addresses and telephone numbers) to credit card issuers.
- Several schools have exclusive marketing agreements with one credit card issuer for which they receive financial compensation.
- Only one school that allows on-campus marketing had a comprehensive written policy specifically governing credit card marketing.

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 9

Similar results are found in other states by other investigators. Some universities have banned or regulated card marketing on campus.

Previously, a PIRG study, the **Credit Card Trap**, released in April 2001, included a detailed study of the worst credit card practices. The report was released at the same time as we announced a detailed fact sheet available at the PIRG website truthaboutcredit.org.²⁶ Because Consumer Action²⁷ releases annual survey data, I will not go into details on the report's survey results. The key findings of a year 2000 survey of 100 credit card offers included in "The Credit Card Trap" are available online²⁸.

(4) BRIEF PROFILE OF THE CREDIT CARD INDUSTRY:

Credit card lending is the most profitable form of lending, according to the Federal Reserve's most recent report to Congress in 2006:

Although profitability for the large credit card banks has risen and fallen over the years, credit card earnings have been consistently higher than returns on all commercial bank activities. For example, for all commercial banks, the average return on all assets, before taxes and extraordinary items, was 1.94 percent in 2005, well below the returns on credit card activities in that year.²⁹

In recent years, those profits have been augmented by rapid increases in fee income.

There may be, as the industry witnesses will trumpet, some 6,000 credit card issuers. But there are only ten that matter. The actual marketplace is highly concentrated.

Since 1980, revolving debt, which is largely credit card debt, increased from just \$56 billion to well over \$800 billion, according to recent Federal Reserve data³⁰. Approximately 55% of consumers carry balances (the rest are convenience users) meaning consumers with credit card balances average \$10-12,000 each in total credit card and revolving debt.³¹

Credit card companies have increased profit by increasing the amount of credit outstanding by decreasing cardholders' minimum monthly payments, increasing interest rates, and piling on enormous fees. Until very recently, credit card companies engaged in a practice of decreasing the minimum percentage of the balance that cardholders must pay in order to remain in good standing. Today, despite recent changes mandated by the OCC to require that minimum payments reduce principal by at least 1%, most companies still require a minimum monthly payment of only 2% or 3% of the outstanding balance. As a result, cardholders who choose to pay only the minimum each month take longer to pay off their balances, paying more interest in the process. In its recent guidance, the OCC admonished banks to raise these minimum payment levels only modestly. "The required minimum payment should be sufficient to cover finance charges and recurring fees and to amortize the principal balance over a reasonable period of time."³² According to a U.S. PIRG analysis, a consumer carrying just \$5,000 of debt at 16% APR would take 26 years to pay off the balance if she only made the 2% requested minimum payment, even if she cut the card up and never used it again.

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 10

And, according to the Fed, industry aggressively seeks new customers: “An industry source indicates that in 2004, 71 percent of US households received an average of 5.7 offers per month, or 58 offers/year.³³ During 2004, US households received an estimated 5.23 billion credit card offers, up 22% compared to 2003 and exceeding the previous record of 5.01 billion offers set in 2001.^{34,}”

(5) POLICY RECOMMENDATIONS OF U.S. PIRG TO ADDRESS ABUSIVE CREDIT CARD PRACTICES:

Prohibit Universal Default: Enact legislation such as H.R. 2146, the “Universal Default Prohibition Act of 2007” sponsored by Rep. Keith Ellison, to ban universal default. We have received numerous complaints that more and more banks are reviewing credit reports of existing customers and raising rates due to a decline in credit score or an alleged one or two late payments to any other creditor, even if the consumer’s payments to the credit card issuer are timely and the account is in good standing. Major issuers have claimed in testimony that the practice is not used in their bank, but they have changed its name, for example to “credit report risk score re-pricing.” While we do not disagree that banks should be able to generally risk-price their products for safety and soundness purposes, we do not believe that universal default is being used as a proportional response. Instead, it is used merely as a tool to increase revenue.

Require Real Disclosure of Minimum Payment Warnings: Rep. David Price and others have introduced H.R. 1510, which that would require every consumer’s credit card billing statement to include a new disclosure. The Minimum Payment Warning is one of the few disclosures that rises above the clutter and will make a difference, and that’s the reason banks vehemently oppose this proposal. The minimum payment warning would tell consumers how many actual years it would take to pay off their specific credit card, at their current balance and interest rate, if they only made the minimum requested payment and never used the card again. We were disappointed when the Senate rejected the similar Akaka amendment during floor consideration of the draconian bankruptcy bill, S. 256, that became law³⁵ in 2005 after being successfully and aggressively sought by the credit card industry. That law includes yet another virtually worthless generic minimum payment disclosure pre-approved by the industry (and still being worked on by the regulators) that will not work to reduce the credit card debts that cripple many American consumers.

Ban Late Fee Penalties When Payments Postmarked Before Due Date: The IRS considers payments postmarked by the due date to be timely. HR 1461, by Mark Udall and others, would implement a similar “postmarked by due date” rule for credit cards. The bill includes a variety of other provisions, including a ban on universal default and limits on marketing to youth.

Ban Other Unfair Practices and Strengthen Disclosures: Following a landmark hearing³⁶ of his Permanent Subcommittee on Investigations, Senator Carl Levin has introduced S. 1395, which prohibits a variety of tawdry interest calculation methods, caps penalty interest rates at 7% above the pre-penalty rate, prohibits collection of interest on fees, requires creditors to give cardholder the option not to exceed credit limit in a transaction, prohibits repeat over-the-limit fees, bans “pay to pay” fees and requires other practices to be adequately disclosed.

Give College Students And Other Young People Only The Credit They Deserve: Credit card companies issue credit to students without looking at credit reports (they don’t have any) and

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 11

without regard to ability to repay. Other Americans must have a good credit report or a co-signer to obtain credit. College students merely apply. College students and other young people should be protected from credit card debt hassles by having to meet similar standards, as HR 1461 would provide. The proposed bill offers several ways for young consumers to qualify to obtain credit cards.

Ban Fees For Paying Bill: In response to complaints from consumers that banks are charging fees to pay bills by phone or computer, Rep. Ackerman has introduced HR 873 to ban fees imposed for timely payment of a bill by phone or electronic transfer.

Further Restrict Pre-Acquired Account Telemarketing: Many of the deceptive practices described in the state actions above involve banks sharing customer information with tawdry third-party telemarketers selling even tawdrier products characterized by over-priced travel clubs and mediocre health insurance plans. In our view, neither the provisions of Gramm-Leach-Bliley dealing with encrypted credit card numbers nor changes to The Telemarketing Sales Rule have adequately stopped banks from treating their customers unfairly due to the lure of massive commissions from their telemarketing partners.

Cap Interest Rates: Reinstate federal usury ceiling for credit cards to prohibit the use of unconscionable penalty interest rates. Prime plus ten per cent seems like a reasonable profit.

Ban Mandatory Pre-Dispute Arbitration: The Congress has enacted legislation protecting car dealers from unfair arbitration clauses in their contracts with car manufacturers. The Senate has in the past passed (and is now considering again) legislation similarly protecting farmers from arbitration in their contracts with powerful agri-business concerns. It is time to enact similar legislation to protect consumers. Rep. Gutierrez has introduced HR 1443, to ban mandatory pre-dispute arbitration in consumer contracts.

Ban The Use of Arbitration in Debt Collection Schemes: Arbitration agreements are not only being used in attempts to prevent consumers victimized by deceptive advertising and interest rate practices to have their day in court. Increasingly, according to a recent report by the National Consumer Law Center, major credit card companies, including First USA and MBNA, are partnering with arbitration firms to establish debt collection mills that force consumers into paying debts, including debts they may not even owe:

Now, at least two giant credit-card issuers and one of the nation's largest firms arbitrating their consumer disputes have combined these practices in a disturbing new way: They're using binding, mandatory arbitration primarily as an offensive weapon, by fast-tracking disputes over credit-card debt into rapid arbitration. A number of consumers charge that the banks often do this with little notice, after long periods of dormancy for the alleged debt or over consumers' specific objections -- then force those who don't respond swiftly or adequately into default. The arbitrator often forces the consumer to also pay for the hefty arbitration costs and the card issuer's attorney, making the total tab for consumers several times the original amount owed and many times what it would have been in more traditional debt settlements. So it's a neat pathway to turbo-charged profits for both the card issuer and the arbitrator.³⁷

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 12

We were disappointed that the Congress in 2005 enacted a one-sided bankruptcy bill, absent proof of abuse, and respectfully urge you to consider our proposals to rein in the unfair credit card company practices described above that have exacerbated the growth of credit card debt, which is the real problem we face, not abuse of the bankruptcy laws. In addition to the bankruptcy law's general manifest harshness and its intended elimination of a critical safety net during uncertain economic times, the bill's nominal credit card disclosures are deficient and unacceptable, as we pointed out above.

In addition to banning certain practices as above, in 2005, U.S. PIRG joined National Consumer Law Center and other leading groups in comments³⁸ to the Federal Reserve on ways to improve credit card disclosures. Those comments were part of the rulemaking that resulted in the recent issuance of proposed rules changes³⁹ by the Fed. The consumer group comments provide a window on the way that the industry exploits loopholes and inconsistencies in the act to hurt and exploit consumers. The TILA was supposed to be a remedial act, a law written to prevent unfair practices, and has often been correctly interpreted that way in the courts, yet the regulators have insisted on allowing the industry to carve out nooks and crannies that allow it avoid the spirit of the law. The proposals augment and update the disclosures in the important 1988 disclosure legislation that established what is known as the "Schumer" box, which requires credit card company solicitations to clearly and prominently disclose all fee and interest related "trigger terms."⁴⁰ We intend to follow additional comments in response to the proposed rule.

Additional key statutory changes recommended in those comments included the following recommendations which were not included in the proposed rule:

- A cap on all other charges, whether considered a finance charge or not, to an amount the card issuer can show is reasonably related to cost.
- No unilateral change-in-terms allowed.
- No retroactive interest rate increases allowed.
- No penalties allowed for behavior not directly linked to the specific card account at issue.
- No over limit fees allowed if issuer permits credit limit to be exceeded.
- No improvident extensions of credit –require real underwriting of the consumer's ability to pay.
- Meaningful penalties for violating any substantive or disclosure that provide real incentives to obey the rules.
- A private right of action to enforce section 5 of the Federal Trade Commission Act, which prohibits unfair or deceptive practices by businesses, including banks.

(6) STATE PREEMPTION ANOTHER PART OF THE PROBLEM

Although states had recently aggressively sought to enforce unfair and deceptive practices laws against credit card companies, the states have been limited in their enforcement by the growing use of preemption theory to restrict their regulation of the industry. In 1978, in *Marquette*,⁴¹ the Supreme Court held that states could export nationally the interest rates of the bank's home state, prompting a concentration of the industry in a few bank-friendly states, including Delaware and South Dakota. In 1996, the court in *Smiley*⁴² extended the *Marquette* holding by defining late fees as "interest," for the purpose of allowing a bank's home state late fees rules to similarly be exported nationally.

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 13

These onerous decisions applied to the regulation of interest. In 2002, a U.S. District Court used National Bank Act preemption theory, backed by the OCC, to overturn an important new California law requiring a monthly minimum payment warning, further restricting the states.⁴³ Then, of course, in 2004, the OCC imposed two onerous administrative rules restricting states from enactment or enforcement against national banks and their state-licensed operating subsidiaries⁴⁴ which has resulted in further court decisions upholding the rules.

These decisions and actions have aided and abetted the anti-consumer practices of this industry and deserve careful scrutiny by the committee. We remain disappointed that, at a minimum, the committee has not reined in the over-reaching OCC rules, although it did in 2004 condemn the OCC⁴⁵ when it passed a bipartisan budget resolution⁴⁶ on a vote of 34-28, stating that the OCC action “may represent an unprecedented expansion of Federal preemption authority” and “comes without congressional authorization, and without a corresponding increase in budget resources for the agency.” The committee also pointed out that without a budget increase, the OCC cannot really expect its modest staff of forty consumer-complaint specialists to both continue their own work and also take over much of the work of an estimated 700 state consumer enforcers and examiners. “In the area of abusive mortgage lending practices alone, State bank supervisory agencies initiated 20,332 investigations in 2003 in response to consumer complaints, which resulted in 4,035 enforcement actions.”

(7) CONCLUSION

We thank you for holding this important oversight hearing. We have attempted to describe a failed enforcement climate that has led to a pattern of sharp industry practices. Improved disclosure is an inadequate solution. The committee must ban unfair practices, it must conduct oversight into the lack of action by federal regulators and it must restore the second two enforcement arms against unfair practices: private enforcement and state attorney general enforcement. We hope that we have provided you with adequate information to support the need for action by the Congress to rein in the credit card industry’s most unfair and abusive practices and would be happy to work with your staffs on proposed legislation.

ENDNOTES

¹ See an Office of the Comptroller of the Currency (OCC) regulatory interpretative letter endorsing debt cancellation and debts suspension products at <http://www.occ.treas.gov/interp/jan01/int903.doc>

² The consumer organizations testifying today, U.S. PIRG and the Center for Responsible Lending, and many others, including the Consumer Federation of America and Consumer Action, are all members of a broad new campaign to educate the public and the Congress about the need to eliminate one-sided binding mandatory arbitration (BMA) clauses in consumer contracts. See <http://www.givemebackmyrights.org/>

³ It is the bank position that the Truth In Lending Act allows them to change fixed rates with as little as fifteen days notice and that a fixed rate is merely a rate that is not variable. A variable rate is defined as one tied to an index, such as the Wall Street Journal prime rate as disclosed on a certain date.

⁴ Primarily a credit card bank, as opposed to a multi-faceted bank with a variety of products.

⁵ Obtain the guidances and copies of the regulatory actions at the OCC credit card practices website available at <http://www.occ.treas.gov/Consumer/creditcard.htm>

⁶ See OCC Consumer Assistance: Process Is Similar To That of Other Regulators But Could Be Improved by Enhanced Outreach, at page 23, U.S. Government Accountability Office, February 2006, available at <http://www.gao.gov/new.items/d06293.pdf>

⁷ Capital One is regulated by the Federal Reserve Board, as a state bank.

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 14

⁸ See testimony of Professor Art Wilmarth, 26 April 2007, before Financial Institutions and Consumer Credit Subcommittee, available at http://www.house.gov/apps/list/hearing/financialsvcs_dem/htwilmarth042607.pdf

⁹ 31 December 2002, FIRST USA TO HALT VENDORS' DECEPTIVE SOLICITATIONS, Press Release of New York Attorney General Eliot Spitzer, available at http://www.oag.state.ny.us/press/2002/dec/dec31a_02.html

¹⁰ 27 Feb 2002, AGREEMENT CURBS TELEMARKETING APPEALS TO BANK CUSTOMERS, Press Release of New York Attorney General Eliot Spitzer, available at http://www.oag.state.ny.us/press/2002/feb/feb27b_02.html

¹¹ See, for example, a temporary injunction against Cross Country for available at

<http://www.ag.state.mn.us/consumer/PDF/CrossCountryBank.pdf>

¹² See "State Sues Cross Country Bank over Harassing Debt Collection Practices," 3 April 2003, Minnesota Attorney General. In November, 2004 the state obtained a temporary injunction barring the bank's abusive practices. See <http://www.ag.state.mn.us/consumer/PDF/CrossCountryBank.pdf>

¹³ 24 June 2004, Press release of Pennsylvania Attorney General's Office "AG Pappert takes action against bank and its collection company in alleged predatory lending/credit card scheme."

¹⁴ 9 May 2005, See news release "ATTORNEY GENERAL DARRELL McGRAW SUES TO ENFORCE SUBPOENAS INVESTIGATING CAPITAL ONE BANK AND CAPITAL ONE SERVICES," available at <http://www.wvago.gov/>

¹⁵ According to the Federal Reserve Board, "8 November 2006 Order Approving Merger of Bank Holding Companies (Capital One and North Fork): The Board notes that in February 2006, Capital One and the State of Minnesota entered into a Consent Judgment, which by its terms constituted a full and final resolution of all claims brought by the state and was not deemed an admission of liability by Capital One. According to the terms of the Consent Judgment, Capital One agreed not to distribute certain advertisements in Minnesota for a period of 18 months after the date of the Consent Judgment and to pay a total of \$749,999, to be divided equally among Minnesota based chapters of the Legal Aid Society, the Minnesota Association of Community Organizations for Reform Now, and the State of Minnesota. Available at <http://132.200.33.130/boarddocs/Press/orders/2006/20061108/attachment.pdf>

¹⁶ See "Providian to Refund \$300 Million to Consumers Over Alleged Abusive Credit Card Practices," 28 June 2000 available at California Attorney General page <http://ag.ca.gov/newsalerts/release.php?id=689&year=2000&month=6>

¹⁷ June 28, 2000, Statement of Comptroller of the Currency John D. Hawke, Jr.

¹⁸ Fact Sheet Regarding Settlement Between the OCC and Direct Merchants Bank, 3 May 2001

¹⁹ Again, these cases and guidnaces are listed here <http://www.occ.treas.gov/Consumer/creditcard.htm>

²⁰ Industry witnesses may trumpet a recent proposed settlement for \$336 million against major banks and the card associations for actions involving credit card foreign transaction fees. We note that that at the core of this case were Sherman Act antitrust violations and the threat of treble damages, not consumer law violations.

²¹ See *Rossman v. Fleet Bank (RI) Nat'l Ass'n*, 280 F.3d 384, 390-91 (3d Cir. 2002) available at <http://laws.lp.findlaw.com/3rd/011094.html>

²² See *Rossman v. Fleet Bank (RI) Nat'l Ass'n*, 280 F.3d 384, 390-91 (3d Cir. 2002) available at <http://laws.lp.findlaw.com/3rd/011094.html>

²³ Eliminating Barriers to Credit and the Challenges of Credit Card Use for Latino Consumers, by Beatriz Ibarra, testimony presented to the U.S. Senate Banking Committee, 1 February 2007, available at <http://www.nclr.org/content/publications/detail/44284/>

²⁴ See "The Burden of Borrowing," the State PIRGs' Higher Education Project, March 2002, available at <http://www.pirg.org/highered/highered.asp?id2=7972>

²⁵ See "Graduating Into Debt: Credit Card Marketing on Maryland College Campuses," February 19, 2004, Maryland Consumer Rights Coalition and Maryland Public Interest Research Group, available at <http://marypirg.org/MD.asp?id2=12264&id3=MD&>

²⁶ "The Roadmap To Avoid Credit Hazards" is downloadable at <http://www.truthaboutcredit.org/roadmap.pdf>.

Numerous other materials and reports are available at <http://www.truthaboutcredit.org>.

²⁷ Available at <http://www.consumer-action.org>

²⁸ See the state PIRG credit card education website <http://www.truthaboutcredit.org>

²⁹ Report to the Congress on the Profitability of Credit Card Operations of Depository Institutions, Federal Reserve Board of Governors, June 2006, available at <http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2006/ccprofit.pdf>

³⁰ The March 2007 data estimate \$888 billion. This figure must be deflated to account for non-credit card debt and for a share of debt that is paid off on a timely, monthly basis, so we use \$800 billion. See G19 Consumer Credit release of 7 May 2007 available at <http://www.federalreserve.gov/releases/g19/current/default.htm>

³¹ The banks frequently cite a Federal Reserve analysis of University of Michigan Survey of Consumer Finances polling data to allege that only 45% of consumers carry a balance. Consumer group contacts with industry sources

Testimony of U.S. PIRG Before U.S. House Subcommittee on Financial Institutions Oversight Hearing On Abusive Credit Card Practices, 7 June 2007, Page 15

indicate that these numbers are low. If true, of course, average balances would be even higher. Consumer groups use a conservative figure of 55% carrying balances, with some sources putting the number as high as high as 60% or more. For a discussion of our analysis of credit card debt, see the state PIRG report "Deflate Your Rate," March 2002, available at <http://www.truthaboutcredit.org>

³² OCC Advisory Letter AL 2004-4, April 28, 2004, available at <http://www.occ.treas.gov/ftp/advisory/2004-4.txt>

³³ "The Profitability of Credit Card Operations of Depository Institutions: An Annual Report by the Board of Governors of the Federal Reserve System, submitted to the Congress pursuant to Section 8 of the Fair Credit and Charge Card Disclosure Act of 1988," June 2006, available at <http://www.federalreserve.gov/boarddocs/rptcongress/creditcard/2006/ccprofit.pdf> We call particular attention to the testimony of victim Wesley Wannamaker.

³⁴ According to Mail Monitor, the direct mail tracking service from Synovate.

³⁵ Public Law No. 109-8.

³⁶ "Credit Card Practices: Fees, Interest Rates, and Grace Periods, 7 March 2007, Hearing of the Senate Permanent Subcommittee on Investigations, available at <http://hsgac.senate.gov/index.cfm?Fuseaction=Hearings.Detail&HearingID=421>

³⁷ See 17 February 2005, "New Trap Door for Consumers: Card Issuers Use Rubber-Stamp Arbitration to Rush Debts Into Default Judgments," National Consumer Law Center, available at <http://www.consumerlaw.org/issues/model/content/ArbitrationNAF.pdf>

³⁸ See Comments of National Consumer Law Center, U.S. PIRG, Consumer Federation of America et al "Regarding Advance Notice of Proposed Rulemaking: Review of the Open-End (Revolving) Credit Rules of Regulation Z," Federal Reserve System, 12 CFR Part 226, Docket No. R-1217 available at http://www.consumerlaw.org/initiatives/test_and_comm/content/open_end_final.pdf

³⁹ See Federal Reserve press release of 23 May 2007 with appendices, available at <http://www.federalreserve.gov/boarddocs/press/bcreg/2007/20070523/default.htm>

⁴⁰ The Fair Credit and Charge Card Act of 1988's disclosures were championed by Representative Chuck Schumer as a member of this committee; he is now a Senator.

⁴¹ In 1978, the Supreme Court in *Marquette vs. First Omaha Service Corp* invalidated state usury laws as they apply to national banks. *Marquette* held that under Section 85 of the National Bank Act (NBA) of 1863 national banks could export to any of their customers, no matter where they lived, the highest interest rate allowed in the bank's home state, now usually Delaware, Virginia, Nevada or South Dakota. See *Marquette Nat. Bank. V. First of Omaha Services*, 439 US 299 (1978).

⁴² In *Smiley*, the Supreme Court extended *Marquette* to allow exportation of a home state's fees. The court paid deference to a new OCC rule that added a wide range of fees to the definition of interest under Section 85 of the National Bank Act, including late fees, over limit fees, annual fees, and cash advance fees. See *Smiley v. Citibank (South Dakota)*, 517 US 735 (1996)

⁴³ Since the federal Truth In Lending was non-preemptive with respect to certain account statement disclosures, California enacted legislation (Civil Code Section 1748.13) requiring that monthly credit card statements disclose information about how long it would take to pay off a card if you only made the minimum requested monthly payment. Federal law did not then require this, although a similar, weaker provision is included in the Bankruptcy law recently signed (Public Law 109-8). The law was overturned on summary judgment in *American Bankers Association v. Lockyer*, 239 F. Supp. 2d 1000, 1009 (E.D. Cal. 2002).

⁴⁴ See the PIRG OCCWatch website for detailed information on the OCC's anti-consumer actions, including links to its rules, <http://www.pirg.org/occwatch> Also see "Preemption Of State Consumer Laws: Federal Interference Is A Market Failure," by U.S. PIRG's Edmund Mierzwinski, which appeared in the Spring 2004 (Vol. 6, No. 1, pgs. 6-12) issue of the *Government, Law and Policy Journal* of the New York State Bar Association. The article includes a major section on the OCC rules, available at <http://www.pirg.org/consumer/pdfs/mierzwinskiarticlefinalnysba.pdf>

⁴⁵ News story on committee vote available here: <http://www.housingchoice.org/news%20stories/2004/02272004.htm>

⁴⁶ See Comm. On Fin. Serv., 108th Cong., *Views And Estimates Of The Committee On Financial Services On Matters To Be Set Forth In The Concurrent Resolution On The Budget For Fiscal Year 2005*, At 15-16 (Comm. Print 2004).